No. 324

Supreme Court of the United States

OCTOBER TERM, 1967

NORFOLK AND WESTERN RAILWAY COMPANY and WABASH RAILROAD COMPANY, *Appellants,*

v.

MISSOURI STATE TAX COMMISSION; HUNTER PHILLIPS; HOWARD L. LOVE; J. RALPH HUTCHINSON, Members of the Missouri State Tax Commission, and J. R. TOWSON, Secretary of the Missouri State Tax Commission, *Appellees.*

ON APPEAL FROM THE SUPREME COURT OF MISSOURI

REPLY BRIEF FOR APPELLANTS

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JANUARY 1968

TABLE OF CONTENTS

TABLE OF CITATIONS

Cases:

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REPLY BRIEF FOR APPELLANTS

The question in this case is whether Missouri has exceeded constitutional limitations on its taxing power by placing on its tax rolls values representing property of the appellant Norfolk & Western that is used by the railroad in conducting its interstate operations outside Missouri. A question indistinguishable in principle has been decided by this Court in at least four cases in which it has invalidated the use by state taxing authorities of mileage ratio methods of assessing property for tax purposes comparable to the

method used by Missouri here. Appellees' answer to these authorities is to say that two of them, *Fargo* v. *Hart*, 193 U.S. 490 (1904), and *Wallace* v. *Hines*, 253 U.S. 66 (1920), involved an issue of valuation different from the issue of allocation of values posed here; and that under the others, *Union Tank Line Co.* v. *Wright*, 249 U.S. 275 (1919), and *Southern Ry.* v. *Kentucky*, 274 U.S. 76 (1927), it is permissible for Missouri to ascribe to itself two or three times the value associated with property in the state since an over-allocation of that magnitude is not so grossly excessive as to be unconstitutional.

In the first two sections of this reply brief we shall take up the appellees' misconceived treatment of the opinions of this Court on which appellants rely. Then we shall deal briefly with their equally mistaken discussion of enhanced value and their odd assertion that the potential for double taxation in what they have attempted to do here raises no constitutional doubt.[1]

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[1] Appellees also suggest that since appellants are "not attacking the constitutionality of the Missouri laws . . . . a constitutional question pursuant to 28 U.S.C., Section 1257(2), has not been raised by appellants." (Appellees' Brief p. 2). Appellants, it is true, have not attacked the Missouri statute as being constitutionally invalid *in toto* and for every purpose, but rather have attacked the statute only as applied to them. (A. 7, 65). But it is absolutely clear that such an attack on a statute, when rejected by a state court, does provide the proper basis for an appeal to this Court. Dahnke-Walker Milling Co. v. Bondurant, 257 U.S. 282, 289 (1921). Indeed, Great Northern Ry. v. Minnesota, 278 U.S. 503, 507 (1929), where this Court held that an appeal was the proper method to review a state decision which sustained a statutory mileage proportion in its particular application, is on all fours with the present case. See also Southern Ry. v. Kentucky, 274 U.S. 76 (1927); Union Tank Line Co. v. Wright, 249 U.S. 275 (1919). Thus, appellees' questioning of this Court's jurisdiction on appeal is completely without merit.

I. Fargo v. Hart and Wallace v. Hines are not "excessive total valuation" cases.

The appellees' argument that *Fargo* v. *Hart,* 193 U.S. 490 (1904), and *Wallace* v. *Hines,* 253 U.S. 66 (1920), involved challenges to the total valuation of the taxpayers, whereas the instant case presents a challenge to Missouri's method of allocation of an agreed total value (Appellees' Brief pp. 10-12),[2] rests on a gross misreading of the two cases. In *Fargo* v. *Hart* the Court stated that "the real question of the case" was whether Indiana had taken into account property that it had no right to impose a tax upon. *Id.* at 498. The vice of Indiana's method of assessment lay in the use of the mileage proportion to bring property into Indiana that had no place there; the vice was not in the valuation of that property. The Court made this very clear in its explanation of the limitations on the circumstances in which a mileage proportion could validly be used;

> "So long as it fairly may be assumed that the different parts of a line are about equal in value a division by mileage is justifiable. But it is recognized in the cases that if for instance a railroad company had terminals in one State equal in value to all the rest of the line through another, the latter State could not make use of the unity of the road to equalize the value of every mile. That would be taxing property outside of the State under a pretense." 193 U.S. at 500.

Similarly, *Wallace* v. *Hines* did not turn on excessive total valuation. There the protesting railroads claimed, and this Court held, that North Dakota's mileage proportion operated unconstitutionally because

[2] Appellees' brief will be cited hereafter as "(Br. —)."

(1) the railroads' property was not evenly distributed over their systems and (2) some of their property brought into North Dakota's tax account by the mileage proportion did not contribute anything to the value of the property in North Dakota. The railroads did not contend that this out-of-state property could not be considered in placing an overall valuation upon them, as, for example, by the United States in levying a tax on their entire business.

Appellants' position here is, therefore, like that of *the taxpayers in those two cases. It* is that Missouri's mileage proportion operated inequitably because there was less rolling stock in Missouri than relative track mileage would indicate and because most of the rolling stock outside Missouri, notably the Norfolk & Western's coal-carrying equipment, contributed nothing to Missouri values. In both of these aspects appellants' challenge is to Missouri's allocation of values. They do not question that the value of the Norfolk & Western's fleet of rolling stock, including its coal cars and special coal train locomotives, was correctly ascertained. There was no occasion for them to raise such a question despite appellees' murky intimations to the contrary. (Br. 15-16).

An attempt by the appellees to distinguish *Fargo* v. *Hart* and *Wallace* v. *Hines* from *Union Tank Line Co.* v. *Wright,* 249 U.S. 275 (1919), which the appellees concede is closely similar to the present case, illuminates the insubstantial nature of their claim that the first two cases dealt merely with "excessive total valuation." Appellees say that "this Court also noted [in *Union Tank Line*] that the rule in *Fargo* v. *Hart,* 193 U.S. 490, did not apply," which they say appears "to distinguish between excessive valuation assessments and indiscriminate application of the mileage

formula . . . ." (Br. 12). There is a statement in the opinion in *Union Tank Line* "that there are no such circumstances as to bring . . . [the case] within the ruling made in Fargo v. Hart, 193 U.S. 490," 249 U.S. at 282, but the quoted language is itself a quotation from the Supreme Court of Georgia, whose decision was being reversed by this Court. Moreover, in *Union Tank Line, Fargo* v. *Hart* was cited twice in support of the holding. 249 U.S. at 282-83, 286. Subsequently, Mr. Justice Holmes in his opinion for a unanimous Court in *Wallace* v. *Hines* cited both *Fargo* v. *Hart* and *Union Tank Line.* 253 U.S. at 70. Thus, it is clear that *Fargo* v. *Hart, Wallace* v. *Hines* and *Union Tank Line* all are grounded in the same principle: a state may not place on its tax rolls property that is outside the state and contributes nothing to the value of the property inside the state.

There is on the books such a case as the appellees profess to find in *Fargo* and *Wallace,* The case is *Great Northern Ry.* v. *Weeks,* 297 U.S. 135 (1936). It condemned a property assessment merely because the valuation base from which the state's share was determined was thought excessive. It was described as the only case of its kind in a dissent, 297 U.S. at 154,[3] and again in a case that limited its authority to its own facts, *Nashville, C. & St. L. Ry.* v. *Browning,* 310 U.S. 362, 371 (1940). In any event, in the *Great Northern*

[3] In the dissent Mr. Justice Stone, joined by Mr. Justice Brandeis and Mr. Justice Cardozo, said that "cases setting aside an excessive allocation of railroad system value to the taxing state," among other categories of cases, "do not support the decision now made." Great Northern Ry. v. Weeks, 297 U.S. 135, 156-57 (1936). The cases cited by the dissenters as involving an excessive allocation, not valuation, were Fargo v. Hart, 193 U.S. 490 (1904); and Rowley v. Chicago & N.W. Ry., 293 U.S. 102 (1934). (See Appellants' Brief p. 28).

case the Court, before making its holding on excessive valuation, rejected an argument of unconstitutional allocation. 297 U.S. at 143-45. Similarly, in *Browning* the authority of *Wallace* v. *Hines* and other cases in the line of decisions invoked by appellants here was recognized, 310 U.S. at 365-66, and the railroad's argument based upon *Great Northern* was treated as a separate and different argument.

In the light of the above, there is no substance whatever to appellees' contention that *Fargo* and *Wallace* are in any legally relevant way different from this case.

II. The nearly 3 to 1 disparity shown by appellants is "grossly excessive."

Having acknowledged that the *Union Tank Line* case is comparable to this one, appellees take up their next line of defense, which is that the overassessment here, even if it arises from an error of law in the application of the Missouri mileage formula, is not so "grossly excessive" as to require invalidation by this Court. They also urge that the assessment is not so "grossly excessive" as was that in *Southern Ry.* v. *Kentucky*, 274 U.S. 76 (1927), another case in which this Court held—and appellees do not deny the holding—that an allocation made pursuant to a mileage proportion was invalid. (Br. 12-13, 16-18).

Union Tank Line, the admitted case of grossly excessive allocation, is described as a case in which the excessiveness was 600 per cent (Br. 13), whereas the appellees, in an obvious and flagrant twisting of words, state that the excessiveness here was only 5 per cent—the difference of 5 percentage points between the 8 per cent of rolling stock value that Missouri ascribed to itself and the 3 per cent of such value represented by rolling stock in Missouri (Br. 15). The state tax au-

thorities in *Union Tank Line* apparently lacked appellees' ingenuity and did not think to argue that all that was involved there was the difference between .45 per cent and 2.8 per cent and that no one could believe that a difference of a mere 2.35 per cent reflected gross excessiveness.[4] Of course, 8 per cent is 267 per cent of 3 per cent. That is the minimum measure of the excessiveness of the assessment here.

Appellees' attempt to show that Missouri's allocation to itself of nearly three times the value of the Norfolk & Western's property in Missouri falls within the boundaries set by this Court's prior decisions is similarly unconvincing. Appellees first state that in *Nashville, C. & St. L. Ry.* v. *Browning,* 310 U.S. 362, 366 (1940), this Court sustained a 3-1 overassessment. (Br. 12-13). Later in their brief, however, the appellees state somewhat more accurately that in *Browning* this Court held "that $16,000,000.00 as opposed to $23,000,000.00 is not excessive." (Br. 17). In fact, the comparison between these two figures in *Browning* is of no aid in deciding the present case. As revealed by the opinion of the Tennessee Supreme Court in *Browning,* 140 S.W.2d 781, 784 (1939), the protesting railroad derived the $16 million figure by capitalizing net operating revenue at 6 per cent, while the $23 million figure was that which was fixed by the state in its assessment. The holding of the Tennessee Court, which was affirmed by this Court, was that the assessment board was not "under any legal compulsion to make the assessment on the basis of capitalization of net income, or to make net income a predominant factor in arriving at the value of the property." In

[4] The questioned assessment was $291,000. That was 2.8% of the system property value of $10.5 million. The company claimed property in Georgia worth $47,000, .45% of system value. Union Tank Line Co. v. Wright, 249 U.S. 275, 277 (1919).

the present case, on the other hand, it is undisputed that the proper aim of the Missouri tax law is to determine the value of rolling stock within the state. See *St. Louis Southwestern Ry.* v. *State Tax Comm'n*, 319 S.W.2d 559 (Mo. 1959). See also *Braniff Airways* v. *Nebraska State Bd.*, 347 U.S. 590, 603 (1954) (concurring opinion). And the figures advanced by appellants before the Commission unquestionably reflect the value of rolling stock within the state on an average. See *Johnson Oil Ref. Co.* v. *Oklahoma ex rel. Mitchell*, 290 U.S. 158, 162 (1933). Moreover, the overassessment in *Browning*, even on the railroad's own theory, was something less than 50 per cent, not nearly 300 per cent as in the present case.

The other two cases cited by appellees are similarly inapposite. In *Railway Express Agency* v. *Virginia*, 358 U.S. 434 (1959), this Court did uphold a tax on 1.7 per cent of an express company's gross receipts, despite a showing that only .6 per cent of its tangible property was located within the taxing state. However, the tax there was on the company's franchise, which comprehended intangible as well as tangible property. This Court noted that there was no showing by the express company that there was a direct relationship between tangible assets in the state and gross receipts, the proper measure of the franchise tax. *Id.* at 443-44. Moreover, there were good grounds for Virginia's claim of 1.7 per cent of the taxpayer's gross receipts, since 1.9 per cent of the taxpayer's total contract mileage was located within the taxing state. *Id.* at 444.

Pittsburgh, C.C. & St. L. Ry. v. *Backus*, 154 U.S. 421 (1894), sheds no light on the instant case. There this Court refused to hold that a mere increase in tax between one year and another, even though nearly

three-fold, in itself made the larger tax unlawful.[5] As Mr. Justice Brewer stated for the majority:

> "Still, it must be borne in mind that a mere increase in the assessment does not prove that the last assessment is wrong. Something more is necessary before it can be adjudged that the assessment is illegal and excessive, and the question which is to be now considered is whether the testimony shows that the assessment made by the state board can be adjudged illegal." 154 U.S. at 432.

The Court went on to consider that testimony and to hold that it supported the taxing state's contention that no tax was levied on property located outside the state. *Backus,* therefore, would be on point only if appellants were arguing that, standing alone, the two-fold increase in the tax between 1964, when the Wabash owned the road, and 1965, when it passed to the hands of the Norfolk & Western, proved the illegality of the Missouri taxing scheme. The appellants' argument, of course, is not based on that single comparison, although that comparison is probative of the excessiveness of the appellees' assessment when it is considered with appellants' evidence that the acquisition of the Wabash road by the Norfolk & Western produced no significant change in operations.

III. The doctrine of "enhanced value" cannot justify Missouri's overassessment.

The appellees' excuse for the overassessment of the Norfolk & Western rolling stock on grounds of the "enhanced value" of that rolling stock due to incorpora-

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[5] The increase was from $8.5 million to $22.7 million and not, as indicated in appellees' brief (Br. 17), from $22 million to $80 million. Pittsburgh, C.C. & St. L. Ry. v. Backus, 154 U.S. 421, 432 (1894).

tion in the Norfolk & Western system merits comment, for appellees seem totally to misconceive the so-called "enhancement doctrine." This misconception is immediately apparent from appellees' own heading of the argument on this point: "The organic relationship of appellants' rolling stock habitually found in Missouri contributes to the value of the Norfolk & Western system." (Br. 13). This stands the doctrine on its head, for the doctrine is based on the premise that intangible system values contribute to the value of the rolling stock habitually found within the taxing state.

Appellees point to three cases cited by appellants—*Pullman Co.* v. *Richardson,* 261 U.S. 330 (1923), *Adams Express Co.* v. *Ohio State Auditor,* 165 U.S. 194 (1897) and *Cleveland, C.C. & St. L. Ry.* v. *Backus,* 154 U.S. 439 (1894)—in which this Court approved the application of a mileage formula to reach enhanced value. Appellees then contend that "there is nothing to distinguish the Missouri law from the cases cited by appellants." (Br. 14). But the difference between the three cited cases and the present case is readily summarized and crucially important—the tax base in those cases was designed to include intangible property.

In *Richardson,* California applied a tax upon the company's property measured by the revenue it generated, thus attempting to reach going concern value, as reflected in gross receipts,[6] and it used a mileage formula to determine what part of those gross receipts could be allocated to California. This is quite unlike Missouri's statute, under which the value of tangible property is measured by its cost less depreciation.

[6] Compare Railway Express Agency v. Virginia, 358 U.S. 434, 441 (1959).

In *Adams Express* and in *Backus,* a mileage proportion was applied to the total value of an express company and of a railroad to determine the property tax on all of the taxpayer's property within the taxing state, not just its express wagons or its rolling stock. Indeed, in *Adams Express* this Court, in discussing prior decisions in which organic values had been considered, made quite clear the distinction between those decisions and *Adams Express,* on the one hand, and the present case, on the other hand:

> "The valuation was, thus, not confined to the wires, poles and instruments of the telegraph company; or the roadbed, ties, rails and spikes of the railroad company; or the cars of the sleeping car company; but included the proportionate part of the value resulting from the combination of the means by which the business was carried on, a value existing to an appreciable extent throughout the entire domain of operation." 165 U.S. at 220-21.

And this Court pointed out that the statute in *Backus* did reach all the railroad's property within the state. *Pittsburgh C.C. & St. L. Ry.* v. *Backus,* 154 U.S. 421, 429-30 (1894). Thus, in each of these cases, prior to the allocation to the taxing state the state tax agency had before it a value for the taxpayer that was meant to include the worth of intangible as well as tangible property.

In the instant case, however, the Missouri Tax Commission did not make any allowance for intangible value of the entire Norfolk & Western system before allocating a part of the value of the carrier's rolling stock to Missouri by way of the mileage formula. Thus, as we urged previously in our brief (Appellants' Brief

34, 38-39), there was no stage at which the Missouri Tax Commission could take into account the intangibles of the Norfolk & Western, if such intangibles did indeed exist. The rhetoric of the court below and of the appellees here, therefore, as to the overassessment of appellants' rolling stock being due to its enhanced value is merely an after-the-fact rationalization for the application of the Missouri tax formula in a situation that does not fit the basic premise of that formula —a substantially even division of the railroad's rolling stock throughout the railroad's entire system. *St. Louis Southwestern Ry.* v. *State Tax Comm'n,* 319 S.W.2d 559, 562 (Mo. 1959).

Adams Express and *Backus* are distinguishable on another important ground. In each of those cases the statute contemplated that all railroads or express companies would be taxed upon their whole values, including intangibles, and therefore would probably pay a tax on a property assessment that was greater than the value of the tangible property, considered separately, within the taxing state. In the instant case, on the other hand, the Norfolk & Western is said to be liable to taxation on its intangibles merely because it does not fit the premise of the statute. Thus, unlike those railroads whose rolling stock is evenly divided throughout the system or those that have a high traffic density in Missouri, only the Norfolk & Western and other railroads with light traffic density in Missouri are subject to a tax on their intangibles. Appellees have cited no cases approving this discriminatory application of the enhancement doctrine, and appellants submit that no such cases exist.

IV. The potential double taxation arising out of the Missouri overassessment is inconsistent with the Commerce clause.

Finally, the appellees argue that "the taxation of property which is within the jurisdiction of the state, at least during a portion of the taxing period, is not rendered objectionable as double taxation by the fact that the same property is, or may be, also assessed for taxation in another state. *Northwest Airlines* v. *State of Minnesota,* 322 U.S. 292 (1944)." (Br. 18). This is a remarkable statement, supported neither by the *Northwest Airlines* case nor any other decision of this Court, and it can only be explained by appellees' disregard of appellants' arguments under the Commerce clause.[7] In *Northwest Airlines* itself, Mr. Justice Frankfurter, announcing the conclusion and judgment of the Court, went to great lengths to point out that this Court was not sanctioning double taxation:

> "The taxability of any part of this fleet by any other State than Minnesota, in view of the taxability of the entire fleet by that State, is not now before us. It was not shown in the Miller Case [202 U.S. 584], and it is not shown here that a defined part of the domiciliary corpus has acquired a permanent location, i.e., a taxing situs, elsewhere." 322 U.S. at 295-96.

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[7] Appellees also cite Illinois Cent. R.R. v. Minnesota, 309 U.S. 157 (1940), as sanctioning double taxation. The brief discussion of the point in that case, however, was directed only to whether the Due Process clause proscribed double taxation. See also State Tax Comm'n v. Aldrich, 316 U.S. 174 (1942). Appellants' argument is not that the Due Process clause proscribes double taxation, but rather that it prevents taxation beyond a state's borders and that the Commerce clause prevents multiple taxation of businesses when it results from the character of their interstate operations. Other cases cited by appellees on this point hold only that the Due Process clause does not prohibit a state from taxing twice one aspect of the affairs of a single entity.

> "The doctrine in the Miller Case, which we here apply, does not subject property permanently located outside of the domiciliary State to double taxation. But not to subject property that has no locality other than the State of its owner's domicile to taxation there would free such floating property from taxation everywhere." 322 U.S. at 300.

This Court has consistently recognized that "multiple taxation of interstate operations" offends the Commerce clause. *Standard Oil Co.* v. *Peck,* 342 U.S. 382, 385 (1952); *Central R.R.* v. *Pennsylvania,* 370 U.S. 607, 612 (1962). Indeed, had this Court sanctioned double taxation, as appellees claim, the *Central Railroad* case, and others like it, would have been decided differently, for there would have been no reason to determine "the extent that [the railroad] could be taxed by another state," 370 U.S. at 614.

Moreover, the appellees' suggestion that a state can tax any property which is located within it during any "portion of the taxing period" (Br. 18), is hopelessly at odds with the guiding constitutional principle in this area: "Property in transit may move so regularly and so continuously that part of it is always in the State. Then the fraction, but no more, may be taxed ad valorem." *Braniff Airways* v. *Nebraska State Bd.,* 347 U.S. 590, 603 (1954) (Mr. Justice Douglas concurring). Undoubtedly there are railroads that have nearly every piece of rolling stock within a number of states during some portion of the tax year. Under appellees' theory those railroads could be taxed at almost the full value of their rolling stock fleet by every such state. Were that so, the Commerce clause might as well be held inapplicable to all interstate carriers.

CONCLUSION

For the reasons stated in our opening brief and in this reply brief the judgment below should be reversed.

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January 1968